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INTELLIGENCE MEMORANDUM

AN EXPLANATION OF THE 1957 REVISIONS
OF SOVIET BLOC EXCHANGE RATES

CIA/RR IM-456

25 September 1957

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CIA/RR IM-456
(ORR Project 42.1988)

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AN EXPLANATION OF THE 1957 REVISIONS
OF SOVIET BLOC EXCHANGE RATES*

Summary

A series of partial adjustments of exchange rates by members of the Soviet Bloc has taken place since early 1957. These changes indicate certain price discrepancies among countries of the Soviet Bloc and between these countries and the Free World, as well as a marked interest by the Bloc in obtaining additional Free World exchange.

The USSR, Poland, Czechoslovakia, Hungary, and Rumania have all announced a depreciation of their respective currencies -- when used for noncommercial transactions -- in terms of the dollar and all other Free World currencies. These same countries have announced adjustments of their noncommercial exchange rates for other Bloc currencies, which in some cases represent an appreciation, in other cases a depreciation, of an individual Satellite currency in terms of the ruble. The new exchange rates apply only to noncommercial transactions, a term which refers to international expenditures for other than commodity trade and commodity transport.

Available evidence suggests that there is a pattern behind these apparently haphazard changes in the exchange rates. The new alignment of exchange rates, both in terms of the dollar and in terms of the ruble, represents a closer approach to that of the internal purchasing powers of Bloc currencies for certain consumer goods and services. In addition, as the new Satellite exchange rates in terms of the dollar appear to represent an undervaluation of Satellite currencies for noncommercial purposes, the evidence supports the official explanation of the devaluations as applied to the West -- namely, that the purpose is one of stimulating receipts of Free World currencies from tourist expenditures and from transmission of pensions, gifts, inheritances, and the like. No official explanations of the new exchange rates of Satellite currencies in terms of

* The estimates and conclusions contained in this memorandum represent the best judgment of ORR as of 1 September 1957.

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one another and the ruble have been forthcoming. The evidence, however, suggests that the new rates represent an attempt to reflect more closely relative purchasing power parities among Bloc currencies while still preserving some purchasing advantage for the ruble.

I. Soviet Bloc - Free World Exchange Rates.

The degree of devaluation to which Soviet Bloc currencies have been subjected in terms of Free World currencies is shown in Table 1.

Table 1

New and Old Exchange Rates of Selected Soviet Bloc Currencies
for Noncommercial Transactions, in Units Per Dollar

Country	Unit of Currency	Old Rates (Per US \$)	New Rates (Per US \$)	Date of Change
Czechoslovakia	Crown	7.17	14.34	1 July 1957 <u>a/</u>
Hungary	Forint	11.74	23.48	1 April 1957 <u>b/</u>
Poland	Zloty	4	24	11 February 1957 <u>c/</u>
Rumania	Leu	6	12	1 July 1957 <u>d/</u>
USSR	Ruble	4	10	1 April 1957 <u>e/</u>

a. 1/. (For serially numbered source references, see Appendix B.)

b. 2/

c. 3/

d. 4/

e. 5/

Three currencies -- the Czechoslovak crown, the Hungarian forint, and the Rumanian leu -- have been depreciated by 100 percent in terms of the dollar; the ruble has experienced a depreciation of 150 percent; and the zloty, 500 percent. These new rates apply only to "non-commercial" transactions, a term which is common parlance among Soviet

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Bloc economists and which refers to all international transactions in the balance of payments on current account except commodity trade, commodity transportation, and the payment and receipt of interest and dividends. The transactions affected by the new rates are therefore largely expenditures of the embassy; transactions involving tourism; and remittances of insurance, annuities, and gifts.

II. European Satellite - Soviet Exchange Rates.

The same European Satellite countries that devalued their currencies for noncommercial purposes in terms of Free World currencies have also revised the value of their currencies for noncommercial transactions in terms of the ruble. The old and new ruble exchange rates of these Satellite countries are shown in Table 2.

Table 2

New and Old Exchange Rates of Selected Soviet Bloc Currencies
for Noncommercial Transactions, in Units Per Ruble

Country	Unit of Currency	Old Rates (Per Ruble)	New Rates (Per Ruble)	Date of Change
Czechoslovakia	Crown	1.79	1.16	1 July 1957 <u>a/</u>
Hungary	Forint	2.96	1.4	21 May 1957 <u>b/</u>
Poland	Zloty	1	1.5	1 May 1957 <u>c/</u>
Rumania	Leu	1.5	0.97	1 June 1957 <u>d/</u>

a. 6/
b. 7/
c. 8/
d. 9/

It will be noted that in terms of the ruble the Polish zloty has been depreciated, while the Czechoslovak crown, the Hungarian forint, and the Rumanian leu have been appreciated. The forint, meanwhile, has been appreciated also in terms of the zloty, the leu, and the crown, implying a depreciation of the last three in terms of the forint. 10/

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It will also be noted that, within the old rate structure, cross rates were neatly aligned and that the new rate structure seemingly offers lush opportunities for arbitrage. Formerly, for example, 1 dollar would exchange for 4 rubles or 4 zlotys and 1 ruble would exchange for 1 zloty. Now, however, 1 dollar will command 10 rubles or 24 zlotys, but 1 ruble will exchange directly for only 1.5 zlotys. Thus with \$10 a person in Poland could purchase 240 zlotys. These 240 zlotys in the USSR would purchase 160 rubles, whereas if the \$10 were spent directly in the USSR, they would buy only 100 rubles. Rigidly enforced direct controls over the purchase and sale of foreign currencies will thus be necessary to prevent Westerners who have noncommercial payments to make in the USSR from doing so by means of the zloty (or the crown, forint, or leu).

III. Rationalization of the New Rates.

The fact that currencies of the Soviet Bloc have been overvalued in terms of Western currencies at official exchange rates has long been recognized. Relative degrees of overvaluation, however -- relative purchasing powers among Bloc currencies -- have not been measured. Information has recently become available, however, which permits a computation of the purchasing power parities of selected Bloc currencies per dollar and per ruble with the results shown in Table 3. The purchasing powers being equated here are those necessary

Table 3

Purchasing Power Parity Per Dollar and Per Ruble
of Selected Soviet Bloc Currencies a/

<u>Country</u>	<u>Unit of Currency</u>	<u>Units of Bloc Currency Per US \$</u>	<u>Units of Bloc Currency Per Ruble</u>
Czechoslovakia	Crown	12	0.9
Hungary	Forint	15	1.1
Poland	Zloty	19	1.4
USSR	Ruble	14	

a. For derivation, see Appendix A.

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to enable a traveler to purchase a middle-class level of living in the capital cities of the different countries in 1955 and 1956. They are therefore well suited for use as a rough measure of the purchasing power parity of Bloc currencies for noncommercial transactions.*

It is instructive to compare these purchasing power parities with the old and new dollar and ruble rates for noncommercial transactions shown in Tables 1 and 2. Under the old rate structure the Polish zloty was subject to the most exaggerated overvaluation in terms of the dollar -- nearly fivefold; the ruble, more than threefold; the crown, nearly twofold. The forint was overvalued more than 25 percent, and the leu about 20 percent. This implies, of course, that the zloty was overvalued in terms of the ruble and that the ruble was overvalued by increasing amounts, in terms of the crown, forint, and leu.

The comparison of the new noncommercial dollar rates with purchasing power parities shown in Table 4** suggests that the Satellites have now undervalued their currencies in terms of Western currencies. Table 4 also indicates that whereas an exchange of 19 zlotys for each dollar would equate a traveler's purchasing power, actually he can acquire 24 zlotys for each dollar. The official statements of the reason for Satellite devaluations -- to increase Satellite receipts of Western currencies -- are thus supported by this information. At these new rates, expenses of travelers in the Satellites will be relatively low. Table 4 also indicates, however, that the ruble is still somewhat overvalued, although to a much smaller degree, at the new rate. This relatively high value of the ruble may reflect the fact that the pressures on the USSR for earning Western currencies are less compelling -- because of the alternative of selling gold -- than are those on the Satellites. It could also indicate a desire on the part of the Kremlin to maintain the prestige of a relatively high rate.

Table 4 also compares the new Satellite noncommercial rates in terms of the ruble with the purchasing power parities between Satellite currencies and the ruble. It is interesting to observe that the zloty, the currency that was devalued in terms of the ruble, is the one which previously had been overvalued; that the other currencies,

* See Appendix A.

** Table 4 follows on p. 6.

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Table 4

Units of Soviet Bloc Currencies Per Dollar and Per Ruble
for Noncommercial Transactions
Compared with Purchasing Power Parities

Country	Unit of Currency	Bloc Currency			
		Units Per Dollar		Units Per Ruble	
		New Rate	Purchasing Power Parity	New Rate	Purchasing Power Parity
Czechoslovakia	Crown	14.34	12	1.16	0.9
Hungary	Forint	23.48	15	1.4	1.1
Poland	Zloty	24	19	1.5	1.4
USSR	Ruble	10	14		

previously undervalued, have been appreciated; and that, although all revised rates now approach more closely purchasing power parities, the ruble is still somewhat overvalued in terms of Satellite currencies. The comparisons of Table 4 thus suggest that although the USSR is now willing to grant more favored (less exploitative) treatment to the Satellites in this regard, it is still preserving some purchasing power advantage for the ruble.

IV. A Portent for the Future?

The 1957 realignment of Bloc exchange rates, partial as it is in the scope of its applicability, is suggestive of a new approach to international economic relationships on the part of Bloc members. Bloc economists have long boasted of the ability of their countries to insulate their own internal economies and price systems from the more volatile shifts occurring in the West. Bloc members have achieved this insulation even while maintaining artificially high legal exchange rates, both in terms of world market prices and in terms of Bloc foreign trade prices. They have, however, succeeded in their insulation only at the expense of their own internal budgets. Because their domestic prices are considerably higher than both Free World and Bloc foreign trade

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prices at official exchange rates, exports, even to other members of the Bloc, have involved them in the payment of extensive subsidies, and imports have resulted in the collection of profits resulting from the price differentials.

The 1957 exchange rate adjustments, in bringing official noncommercial rates closer to the levels that would normally have resulted from the operation of market forces (rates determined by the purchasing power parities of the various currencies), could be viewed as the first step by the Bloc toward a more realistic structure of rates for all purposes, commercial as well as noncommercial. There has been increasing evidence of late in the press of Bloc countries of their dissatisfaction with a system of foreign trade administration which makes difficult if not impossible a comparison of relative costs of imports as opposed to domestic production. Moreover, available evidence suggests that since 1950 actual prices in intra-Bloc trade have been moving toward the level of Free World prices. As Bloc foreign trade is increasingly conducted at world market prices, the institution of a general system of realistic exchange rates would seem to offer significant advantages. A system of official exchange rates reflecting relative purchasing powers not only would encourage a more economic pattern of trade and production but also would permit the elimination of the ridiculously complex system of subsidies and profits which Bloc foreign trade now entails.

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APPENDIX A

RELATIVE PURCHASING POWERS
OF CERTAIN SOVIET BLOC CURRENCIES

Information which has recently become available on the per diem allowances for Rumanian officials traveling abroad indicates the official Rumanian view of relative costs of living in certain Soviet Bloc countries. Indirectly it indicates the purchasing power parity of certain Bloc currencies for a middle-class level of living in the capitals of these countries.

In 1955 and 1956, Rumanian officials* traveling abroad on temporary duty were paid per diem allowances of the following amounts in the currency of the country in which they were visiting 11/:

Czechoslovakia	160 crowns
France	4,500 francs
Hungary	200 forints
Poland	250 zlotys
USSR	180 rubles

Because the reason for per diem allowances is to enable the traveler to live at the same level in all locations, it can be assumed that the basket of goods which could be purchased for 200 forints in Hungary would require 180 rubles in the USSR, 4,500 francs in France, 160 crowns in Czechoslovakia, and 250 zlotys in Poland. It can also be assumed that the approximate US purchasing power of these allowances was \$13 because on the average in 1955 and 1956 the free franc rate approximated 350 francs to \$1.

* While a Rumanian official is away on business, his salary is sent directly to his family; he draws his per diem allowance from the Rumanian Embassy in the country which he is visiting, the allowance being paid in the currency of the country.

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APPENDIX B

SOURCE REFERENCES

Evaluations, following the classification entry and designated "Eval.," have the following significance:

<u>Source of Information</u>	<u>Information</u>
Doc. - Documentary	1 - Confirmed by other sources
A - Completely reliable	2 - Probably true
B - Usually reliable	3 - Possibly true
C - Fairly reliable	4 - Doubtful
D - Not usually reliable	5 - Probably false
E - Not reliable	6 - Cannot be judged
F - Cannot be judged	

"Documentary" refers to original documents of foreign governments and organizations; copies or translations of such documents by a staff officer; or information extracted from such documents by a staff officer, all of which may carry the field evaluation "Documentary."

Evaluations not otherwise designated are those appearing on the cited document; those designated "RR" are by the author of this report. No "RR" evaluation is given when the author agrees with the evaluation on the cited document.

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Approved For Release 1999/09/21 : CIA-RDP79T00935A000400330004-1

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